STATE OF CALIFORNIA

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Dear Interested Party:

Attached is a copy of Current Legal Digest (CLD) Number 1080 for your information and review. This CLD contains eight new annotations, five revisions to existing annotations, and eleven deletions of existing annotations. After review, please submit any questions, comments, or suggestions for changes by January 4, 2013. You may complete the electronic CLD Comments Form at http://www.boe.ca.gov/sutax/cld/cldmail.htm, or mail your written comments to:

Board of Equalization
Annotation Coordinator, MIC:50
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Please note, the new annotations, and/or suggested revisions of existing annotations, contained in the attached CLD are drafts and may not accurately reflect the Board's official position on certain issues nor reflect the language that will be used in the final annotation.

CLDs are circulated for 30 days, at which time any questions are addressed and/or suggested modifications taken into consideration. After review of the final version by the Board's Legal Division, they are published in the Business Taxes Law Guide. At that time, the CLD becomes obsolete.

Robert Tucker
Assistant Chief Counsel

Attachment: Current Legal Digest 1080

195.0085 **Blood Collection and Pack Units**. Section 6364.5 exempts from tax transactions involving the sales and use of certain containers associated with blood collection. The legislative history of Assembly Bill 993 (Stats. 1997, Ch. 773), hereafter AB 993, the bill that created Section 6364.5, demonstrates that the intent of Section 6364.5 was to provide a narrow exemption. The fiscal effect of AB 993 was calculated using total sales and average costs of blood bags, platelet aspheresis kits, plasma kits, and transfer bags. Each of these items includes a bag in which the blood product is stored. No other items besides these were included in the calculation of fiscal effect.

The reference within the statute to containers that "collect or store" blood products refers to units such as blood collection units or blood pack units that include not only a bag, but also integrated components which collect the blood product stored in the bag. The language of the statute and the legislative history demonstrate that the exemption was not intended to apply to transactions involving the sale of syringes and pipettes which may collect blood or any item on which blood may be tested or temporarily held for other purposes. Based on the language of the statute and the legislative history, the exemption provided by section 6364.5 applies to products analogous in function to the units described in Section 6364.5, subdivision (b) and those listed in the fiscal impact statement in the legislative history. 8/11/11.

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195.1455 **Deposits on Automotive Refrigerant Containers**. California Code of Regulations, title 17, sections (hereafter ARB Regulation) 95360-95370, implement a recycling program associated with sales of small containers of automotive refrigerant. Under the program, retailers collect a deposit from the consumer or charge the consumer's account for each small container of automotive refrigerant at the time of sale. The container deposit collected by retailers, as defined by ARB Regulation 95361, subdivision (a)(19), is a deposit under Regulation 1589, subdivision (a) and is not subject to tax. 3/16/11.

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245.0732 **Medicines – Medical Foods**. Products known as "medical foods," as defined under Section 5(b) of the federal Orphan Drug Act, are medicines pursuant to Section 6369. The sale of "medical foods" would not qualify for the Section 6359 exemption for food products because medicines are specifically excluded from the definition of a food product. Therefore, tax generally applies to retail sales of "medical foods," including over-the-counter sales. However, "medical foods" that are sold or furnished in an exempt manner as specified in Regulation 1591, subdivision (d)(1)-(6), are not subject to tax. 10/21/09.

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Note: The new proposed annotations contained in this CLD are drafts and may not accurately reflect the text of the final annotation.

Delete Annotation 305.0012, **F.O.B. Shipment by Mail or Common Carrier to Indian Reservations**, (12/17/03; 4/28/05) due to the determination that the provision requiring that the transportation documents, such as a bill of lading, stipulate delivery is at destination (F.O.B. reservation) need not be met for the transaction to qualify as a sale on the reservation provided the transportation documents do not contain any language contradictory to the language contained in the contract of sale.

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Delete Annotation 305.0028.025, **Non-Indian Construction Contractor May Qualify as Retailer of Materials to Indians**, (6/12/02) due to the determination that the provision requiring that the transportation documents, such as a bill of lading, stipulate delivery is at destination (F.O.B. reservation) need not be met for the transaction to qualify as a sale on the reservation provided the transportation documents do not contain any language contradictory to the language contained in the contract of sale.

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Delete Annotations 330.2103, **Computerized Dictation/Transcription Systems**, (7/15/81); 330.2215 and 515.011.135, **Equipment and Software Furnished with Database Access**, (10/28/96); 330.2310.050 and 120.0015.800, **Lease of Software**, (8/1/86); 330.2318, **Licensing of CD-ROM and Related Software**, (8/4/94); and 330.3428, **Lease of Compact Disks**, (11/21/94). Due to the potential for these annotations to be misinterpreted, they are being deleted. The basic rule for determining whether property is leased in substantially the same form as acquired is set forth in annotation 330.3900, **General Rule – Substantial Change in Form**, (2/17/67, 5/2/94) and the rule as applied to software is clarified in annotation 330.3950, **Computer Hardware and Prewritten Software** (10/24/11).

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330.3126; 570.1659 **Leases Subject to Use Tax — Section 6406 Credit**. An out-of-state retailer (lessor) is engaged in the business of leasing motor vehicles. After lease inception, some of the lessees relocate to California and bring the leased vehicles with them. The lessor did not pay California sales tax reimbursement or make a timely election to report California use tax measured by the purchase price of the motor vehicles. As a result, these lessees become liable for California's use tax on the remaining lease payments and the lessor is obligated to collect this tax from each of these lessees as the payments become due. Thus, if a lessee is entitled to a Section 6406 credit against the California use tax for tax or tax reimbursement paid to another jurisdiction (lease state) on the same lease payments, the lessor's obligation to collect California use tax from the lessee is limited to the lessee's actual use tax liability after application of the credit.

The Section 6406 credit may be available to a lessee for an "up-front tax" previously imposed by the lease state. An "up-front tax" is measured by the total dollar amount of all the payments due under the lease and is imposed at lease inception. For "up-front leases," a Section 6406 credit is available to the lessee to the extent that the lessee paid tax directly to the lease state or paid a separately stated and identified amount of "tax" or "tax reimbursement" to the lessor for the lease

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payments that are subsequently subject to use tax in California. The lessee's Section 6406 credit will not exceed the amount of tax actually imposed on the lessee's lease payments. Accordingly, for example, no Section 6406 credit is available to a lessee for taxes imposed or due on the lessor's purchase, titling or registration of a vehicle that will be used for leasing purposes even though the lessor may have shifted the economic burden of this tax to the lessee.

When a lessee's lease payment is subsequently subject to California's use tax, such as when the leased property is present in California during the lease period (billing cycle) covering that payment, the creditable amount for that lease payment is also limited to the amount of tax that was previously imposed up-front by the lease state on that specific lease payment. In other words, the lessee does not receive a lump-sum Section 6406 credit equal to the total amount of tax paid up-front to the lease state at lease inception. Instead, we allocate the up-front payment of tax proportionately to every lease period included in the measure of the lease state's "up-front tax," and the Section 6406 credit is only available to a lessee against California use tax due on a lease payment to the extent that specific lease payment was previously subject to tax in the lease state.

The Section 6406 credit may also be available to a lessee if the lease state imposes a tax on the individual lease payments as they become due and payable by the lessee for each billing cycle specified under the lease. When a lease state imposes a tax on a lease payment for a specific billing cycle, the Section 6406 credit for such tax may only be applied to reduce California use tax imposed on that same lease payment covering that same billing cycle. Furthermore, the credit is only available to the extent the lessee directly paid tax to the lease state or the lessee directly paid a separately stated and identified amount of "tax" or "tax reimbursement" to the lessor for the same lease payment that is subsequently subject to tax in California.

In light of the foregoing, in any claim for credit the claimant must be able to prove that: (1) the lease state's tax was actually imposed on the lease transaction at issue between the lessor and the lessee; (2) the lessee directly paid the amount for which credit is claimed to the lease state or paid to the lessor an agreed upon and separately stated amount for that tax or tax reimbursement; and (3) the lease state's tax for which a credit is claimed was actually imposed on the same lease payments that are subject to California use tax. When a lessor's purchase or registration of a motor vehicle is subject to tax in a lease state, the lessee cannot claim a credit for such a tax even if the lessor shifts the economic burden of the tax to the lessee. No credit is ever available for tax allocable to and/or paid for a lease payment covering a billing cycle prior to the storage, use, or other consumption of leased property in California. Further, the transaction at issue must have originally been first subject to tax outside this state (i.e., at a time prior to the storage, use, or other consumption of the leased property in this state.) Finally, if a lessee paid otherwise creditable tax or tax reimbursement to a lessor, the lessee cannot claim a Section 6406 credit unless the lessor actually paid the tax to the lease state or the lessee received and retained a receipt for the tax from the lessor as explained in Regulation 1686. 6/15/09; 10/26/09.

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Revise Annotations 330.3128 and 570.1662 to clarify that the primary factor to consider for the Section 6406 credit is not whether the liability to pay the tax is imposed on the lessor or the

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lessee, but on whether there was any tax imposed on the lease transaction or whether the lease was ex-tax.

330.3128; 570.1662 **Lessee – Credit for Tax Paid to Texas**. A lessee entered into a multi-year lease of a vehicle in Texas and thereafter brought the vehicle into California where subsequent payments due under the lease became subject to California use tax~~moved to California, bringing the vehicle with him~~. The lease contract showed an amount of $3,147.38 in "rental tax" paid to the lessor~~the state of Texas~~.

Texas imposes tax on the sale of a vehicle to or the purchase of a vehicle by a person who will lease the vehicle for periods of more than 180 days and tax does not apply to the lease receipts from the subsequent lease. Therefore, in Texas,~~In Texas~~ the tax is imposed on the lessor's purchase of a vehicle for leasing purposes, although the lessee may end up bearing the ultimate economic burden. In California, the use tax is imposed on the lessee and is measured by the rental or lease payments due for the periods the vehicle is in California. Since the Texas tax is imposed on a different transaction~~person~~ (the lessor's purchase), the section 6406 credit is not available to the lessee for using the leased vehicle in California. ~~Furthermore, the section 6406 credit is not allowed against taxes measured by the periodic payments due under a lease to the extent that the taxes imposed by the other state were also measured by periodic payments made under the lease for a period prior to the use of the property in this state.~~

The section 6406 credit may not be used to offset the Texas tax imposed on the lessor's purchase of the vehicle against the California use tax the lessee owes on the lease payments because the Texas tax was not imposed on the lease payments that are subject to California tax. Accordingly, the lease of the vehicle is subject to California use tax for periods in which the vehicle is in this state. 3/16/95.

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330.3950 Computer Hardware and Prewritten Software. Taxpayer loads prewritten software onto a computer and leases them as a single unit in transactions that are true leases. Taxpayer pays sales tax reimbursement or use tax to its vendors when it separately purchases the computer hardware and the prewritten software. Taxpayer does not separately charge for the installation of the leased software onto the leased computer hardware. Taxpayer also provides its customers possession of the originally purchased storage media containing the prewritten software (e.g., the original disks provided by the software vendor) so that the customer may re-install the leased software onto the leased computer hardware if necessary.

Taxpayer has created a unit by merely loading the software onto the computer hardware prior to transferring the property to its customers. Taxpayer does not perform significant fabrication labor to the leased computer. The property is rented in substantially the same form as acquired. That is, the general functional capabilities, characteristics, or form of the property has not been significantly changed following Taxpayer's acquisition. Given these facts, no sales or use tax is due with respect to the amounts charged for such rentals. 10/24/11.

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425.0151 **Medicines – Medical Foods**. Products known as "medical foods," as defined under Section 5(b) of the federal Orphan Drug Act, are medicines pursuant to Section 6369. The sale of "medical foods" would not qualify for the Section 6359 exemption for food products because medicines are specifically excluded from the definition of a food product. Therefore, tax generally applies to retail sales of "medical foods," including over-the-counter sales. However, "medical foods" that are sold or furnished in an exempt manner as specified in Regulation 1591, subdivision (d)(1)-(6), are not subject to tax. 10/21/09.

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Delete Annotations 465.0030 and 465.0031, **Withdrawal of Petition for Redetermination**, (6/28/83) since the annotations are duplicative of Annotation 465.0545, *Claim for Increase in Determination*, and Annotation 465.0545 contains the most clear statements of the relevant law.

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Revise Annotation 570.1603 to clarify that the annotation discusses tax reimbursement paid to an Arizona lessor on rental payments as they become due under a lease and to clarify that no credit is available for another state's tax that is imposed after the storage or use of rented property in California. **Arizona Tax**. We understand that ~~The~~ Arizona tax is imposed upon every person engaging within the state in the business of leasing or renting tangible personal property. As a business privilege tax, the Arizona tax qualifies as a retail sales tax for purposes of section 6406. Therefore, a lessee who has paid a~~the~~ lessor tax reimbursement for the Arizona tax ~~for leased property situated in California can~~ imposed on lease or rental payments may offset that tax against the California use tax ~~based upon the rentals payable~~ imposed on the same lease or rental payments, assuming the Arizona tax was imposed prior to the storage, use, or other consumption of the leased property in this state. 9/18/70.

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Revise Annotation 570.1623 to clarify that the lessee did not pay any tax or tax reimbursement to another state and to remove the second paragraph of the annotation as there is a better discussion in proposed annotations 330.3126 and 570.1659, *Leases Subject to Use Tax – Section 6406 Credit*, on how the 6406 credit applies when another state imposes a tax on individual lease payments as they become due. **Credit for Tax Imposed by Other States**. A vehicle is leased in a state that imposes on the lessor a tax that must be paid upon the inception of the lease and there is no indication that the lessee paid tax reimbursement to the lessor. The vehicle is relocated to California by the lessee. Unless the lessor has paid California use tax or California sales tax reimbursement, a "purchase" as defined in section 6010(e)(5) results. When a lease is a purchase, California tax applies measured by rentals payable for the period during which the vehicle is located in this state. The applicable tax is the use tax which is due from the lessee, although it must be collected and paid by the lessor. No credit for tax the lessor paid to another state is allowable against the lessee's use tax liability in this situation because section 6406, which authorizes such credit, allows it only in situations in which the lessee paid tax or tax reimbursement to another state ~~of both states has been paid by the same person~~. Where the other

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state's tax is imposed on the lessor, the credit is not allowable, unless the lessee pays the lessor tax reimbursement with regard to the eligible lease payments, since the California use tax is imposed on the lessee.

~~Even if the other state's law permitted the tax to be paid on rentals, no offsetting credit would be allowed unless the other state required that tax payments continue to be made while the vehicle was in California. If such tax is imposed while the property is in California, a section 6406 credit is available for the period the vehicle is in California.~~ 8/15/90.

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Revise Annotation 570.1660 to distinguish between the creditable nature of Nevada taxes imposed on lease payments and the noncreditable nature of Nevada taxes imposed on a lessor's purchase of property for leasing purposes. **Lessee**. ~~A lessee who leases equipment from a Nevada dealer and who brings the equipment into California for use in California must pay tax measured by the rental price of the equipment, unless the lessor of the equipment has paid California sales tax reimbursement or use tax with respect to the property. A credit will be allowed against the California tax only if the lessee himself pays to the lessor, or to Nevada, the Nevada sales tax or use tax or sales or use tax reimbursement for the periods that the equipment is present in California.~~ Under Nevada law a lessor may elect to pay tax on the purchase or sales price of property intended for leasing and, if the election is made, the subsequent lease receipts will not be subject to tax. If no election is made, the lessor must pay the Nevada tax on the lease receipts and may collect tax reimbursement from the lessee.

A lessee who initially leases tangible personal property in Nevada from a Nevada lessor and who subsequently brings the property into California for use in California must pay California use tax measured by the lease payments due for the billing periods that the property is in California, subject to any applicable Section 6406 credit. If the Nevada lessor did not make any election and the Nevada tax was therefore previously imposed on the lease receipts, the lessee will only be entitled to a credit against the California use tax to the extent that the lessee directly pays, to the lessor or to Nevada, Nevada sales tax or use tax imposed on the same lease payments, or reimbursement therefor. On the other hand, if the lessor elected to pay Nevada tax on the lessor's purchase of the leased property, no amount of credit under Section 6406 is available to the lessee. 7/17/69.

229.0010 -- Solar Facility. A hay and cattle rancher designed a solar facility for use on its ranch. The purchase of a solar facility may qualify for the farm equipment and machinery partial exemption. To qualify for the partial exemption there must be (1) a qualified person who (2) purchases qualifying farm equipment and machinery and (3) uses that equipment and machinery primarily in producing and harvesting agricultural products.

A qualified person means any person engaged in a line of business described in Codes 0111 to 0291, inclusive, of the Standard Industrial Classification (SIC) Manual. Hay farming is described in SIC Code 0139, and cattle ranching is described in SIC Code 0212. Therefore, a hay and cattle rancher is a qualified person.

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A solar facility may constitute farm equipment and machinery if it constitutes equipment used to operate qualifying farm equipment and machinery. Specifically, the taxpayer needs to demonstrate that the solar facility is specifically designed to provide power to qualifying farm equipment and machinery. The rancher designed the solar facility to generate 90 percent of the total amount of electric power consumed by the ranch's irrigation pumps each year based on a three-year average. The ranch is prohibited by the electric cooperative, of which the ranch is a member, from attaching the solar facility directly to the irrigation pumps. Instead, the solar facility is tied to the regional power grid and subject to a net metering agreement between the ranch and the electric cooperative. Based on all these facts and circumstances, this solar facility is specifically designed to provide electric power to the irrigation pumps. Therefore, the solar facility is equipment used to operate (i.e., to power) qualifying machinery, irrigation pumps or an irrigation system, and thus the solar facility itself constitutes farm equipment and machinery as defined in Regulation 1533.1, subdivision (b)(1)(A).

To determine whether the solar facility is primarily used in producing and harvesting agricultural products, fifty percent or more of the annual energy generated by the solar facility must be consumed by the ranch's irrigation pumps in producing and harvesting agricultural products. Specifically, this is calculated by dividing the total annual amount of power consumed by the ranch's irrigation pumps in producing and harvesting agricultural products by the total annual amount of power generated by the solar facility. The irrigation pumps, which are powered by the solar facility, are used solely for those activities described in SIC Code 0139 and SIC Code 0212. Each year, the solar facility will generate 90 percent of the amount of electric power that the irrigation pumps consume. Under such facts, all of the electric power generated by the solar facility effectively is consumed by the irrigation pumps in producing and harvesting agricultural products. Therefore, the solar facility is used 50 percent or more of the time in producing and harvesting agricultural products.

The solar facility was furnished and installed by a construction contractor. To the extent the construction contractor is regarded as a retailer under Regulation 1521, the partial exemption applies to the sale of such items to the qualified person. However, to the extent the construction contractor is regarded as the consumer under Regulation 1521, the partial exemption is not applicable to the construction contractor's purchase of materials consumed in constructing the solar facility. 12/15/11.

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